Attorney General of New Mexico

PO Drawer 1508
Santa Fe, New Mexico 87504-1508

(505) 827-6000
Fax (505) 827-5826

PATRICIA A.
MADRID
Attorney General

STUART M.
BLUESTONE
Deputy Attorney General

November 30, 2001

Hon. David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

Re: Arizona Public Service Company, Docket Nos. EL02-9-000 and RT02-1-000 and Electricity Market Design and Structure, Docket No. RM01-12-000

Dear Secretary Boergers:

Attached for filing via the FERC's Electronic Filing Program is an electronic file containing this transmittal letter, the "Protest of the New Mexico Attorney General," a "Request for Addition to Service List" and the "Certificate of Service" for the same in the above-referenced proceedings.

Thank you for your assistance.

Sincerely,

/s/

Deborah R. Tope
Paralegal
New Mexico Attorney General's Office

cc: Service List

Enclosures

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Arizona Public Service Company El Paso Electric Company Public Service Company of New Mexico Tucson Electric Power Company	Docket No. EL02-9-000
WestConnect RTO, LLC	Docket No. RT02-1-000
Electricity Market Design and Structure	Docket No. RM 01-12-000

PROTEST OF THE NEW MEXICO ATTORNEY GENERAL

The Office of the New Mexico Attorney General ("Attorney General") respectfully submits its Protest of the WestConnect filing. On October 16, 2001, the Arizona Public Service Company, El Paso Electric Company, Public Service Company of New Mexico and Tucson Electric Power Company ("Applicants") filed their Joint Petition for Declaratory Order requesting Commission confirmation that their joint proposal to form WestConnect RTO, LLC ("WestConnect"), a for-profit regional transmission organization ("RTO") which is proposed to serve a portion of the western United States, meets or exceeds the Commission's requirements for the formation of RTOs under Order No. 2000.

In its Notice of Filing, issued October 24, 2001, the Commission set a deadline of November 15, 2001 for intervention motions and protests to be filed. The Attorney General, on November 8, 2001, filed the Motion to Intervene and Protest of the New Mexico Attorney General. In that motion, the Attorney General indicated that, based on the limited review that time has permitted to date, this office will protest the WestConnect filing and indicated that further time will be required to formalize a specific position on the numerous issues raised by the

applicants. The Commission granted an extension of time to file motions to intervene and protests until November 30, 2001.

I. NEW MEXICO ATTORNEY GENERAL PROTEST

A. Introduction

The comments filed herein are made with the caveat that the New Mexico Attorney General opposes FERC's efforts to seize jurisdictional control of all utility transmission assets through the formation of RTOs. Under the Federal Power Act, FERC was given jurisdiction only over wholesale transactions and transmission matters "… which are not subject to jurisdiction by the states." U.S.C. § 824(a). Thus, under current law, FERC does not control access, price or terms for transmission that a utility uses in making bundled sales to its retail customers. By seeking the formation of RTO "middlemen," FERC is seeking to transform utility retail transactions into wholesale transactions over which it would then have jurisdiction. Yet no showing has ever been made that RTOs would provide any benefit to electricity consumers. Their sole purpose is to facilitate the move to electric competition – a move that many western states have not yet decided to make and which Congress has not approved. Moreover, there is no evidence that a national electricity market is desirable or even possible.

The New Mexico Attorney General believes that preservation of utility control of transmission under state regulation is fundamental to protection of retail electric service. In states that have not adopted deregulation, all transmission assets owned by a utility are included in state-jurisdictional rate base. Retail utility customers pay for depreciation, operating maintenance and return on capital for all these facilities at rates set by local regulators. If any of these facilities are used for wholesale transactions, FERC has jurisdictional authority, although this authority only extends to the use of transmission capacity that is *surplus* to the capacity

needed by the utility to serve its retail customers. FERC's jurisdiction applies only to transmission that is in excess of what is needed to serve retail customers – a "native load reservation." Excess transmission capacity must be made competitively available on a non-discrimination basis. Revenue derived from these wholesale transaction is then credited by state regulators to offset local retail rates.

Under RTO proposals, transmission would no longer be a retail service used to provide reliable power to retail customers, but would become wholesale service available for general commercial use, which could undermine the certainty of transmission availability to support bundled retail service. It would appear to change the public purpose for which transmission was originally built to one of promoting wholesale competition.

While RTOs may be useful, there has been no showing of any kind that they would improve reliability, lower costs or result in improved electric service. Without such a showing, the state commissions should not permit a sale or transfer of assets from retail service.

B. WestConnect Does Not Meet the Standards of Order No. 2000

The Attorney General offers these comments to FERC on the October 15, 2001 filing of the WestConnect RTO in Docket Nos. EL02-9-000/RT02-1-000. The conclusion of these comments is that the Attorney General is firmly opposed to the establishment of the WestConnect RTO unless many fatal flaws and major weaknesses of the filing are completely remedied. However, these flaws and weaknesses will not be easy to remedy, and will require the active participation of stakeholders such as the Attorney General to resolve. One reason why these flaws and weaknesses will not be easy to remedy is because some of them flow directly from illogical and contradictory aspects of FERC Order No. 2000. These illogical and contradictory prescriptions that FERC laid out for the electric utility industry relative to the

formation of all RTOs will have to be fixed first. In fact, new FERC Notices Of Proposed Rulemakings may have to be litigated first, before a clear and socially useful concept of RTOs can be established. Once appropriate changes are made to the WestConnect filing, and it is re-submitted to FERC, the parties to this docket should be allowed further opportunity to comment, since the present filing is so far from an adequate filing.

The Attorney General notes that in its November 7, 2001 Order in Docket No. RM01-12-000, the Commission stated on page 3 that it will take several immediate steps to move the RTO process forward, including establishing "a broader definition of how certain RTO functions will be fulfilled." Furthermore, on page 4 of the same Order, FERC stated that it "will be seeking comments on other ways wholesale market activities might be fulfilled." Below the Attorney General offers FERC some ideas for how to eliminate some of the more troublesome components of RTOs as spelled out in the Commission's Order No. 2000, and the Attorney General explains why a broader definition of an RTO should imply reconsideration of many of the desirable features of *tight power pools*, as they had been established in the past. Establishing a tight power pool in the WestConnect region prior to, or instead of, establishing an RTO might accomplish most if not all of what FERC desires relative to minimizing electric rates, without subjecting consumers throughout this region to unacceptable market risks that establishing an RTO might bring to the region. In fact, a tight power pool might provide a way of getting the operation of the diverse transmission and generation systems of this region of the country up to a level of coordination that has not yet existed which makes further steps towards an RTO more conceivable, if such steps are found upon further analysis to be desirable. For example, establishing a tight power pool might eventually provide FERC and state utility regulators with the appropriate *cost baseline* to which further cost/benefit analyses could be compared in order to

attempt to measure any *incremental* benefits that an RTO (based on FERC's current conception) might offer. Thus, FERC should explore the concept of establishing a tight regional power pool in the desert Southwest with the various stakeholders in the WestConnect region *prior to approving any form* of a WestConnect RTO.

The fatal flaws and major weaknesses of the WestConnect filing are:

1. The threat of market power in all electricity markets is a very serious threat. If FERC ever imposes a deregulated Energy Balancing market mechanism on the states covered by the proposed WestConnect RTO, it must also establish an installed capacity balancing market mechanism to help mitigate the potential market power implications of an energy-only spot market. One of FERC's major errors in restructuring the California electricity markets was not to have included an installed capacity market as was done in the Northeastern ISO markets. An installed capacity balancing mechanism is also needed to ensure that all load serving entities (distribution utilities) maintain sufficient amounts of installed generation capacity to preserve system reliability. Not doing this in California was a further problem. Not providing an installed capacity balancing market for WestConnect would be a *fatal flaw*. However, a regulated Energy Balancing mechanism based on actual *costs* rather than *bids* would also be highly preferable, at least until the WestConnect RTO develops sufficient levels of operating experience that it can be determined whether or not adopting a *deregulated* energy and capacity market mechanism will lead to net benefits customers in the region relative to an appropriate *cost baseline*.

2. WestConnect does not develop and specify the "assessment standards" that it will use to identify the exercise of market power in any of the market structures that it will monitor at all. Unfortunately, neither does FERC in Order No. 2000, since FERC has never provided utilities with a clear conception of how a workably competitive wholesale electric market would

be structured, and how it would operate. This is a fatal flaw, because providing appropriate assessment standards, or an appropriate cost-based pricing baseline for a regional power market within an RTO, is a difficult and controversial aspect of attempting to create competitive regional markets. A proposal which only provides the proposed market structures, without an assessment standard for determining when market power is or is not present, is not adequate. Appendix H (section H.4.a.) of the WestConnect filing merely states that "WestConnect shall develop and publish" these market power assessment standards in the future. Without any statement of the methodology to be used to detect market power when it is being exercised, this filing must be rejected, since such a methodology is just as important to develop at this stage in the development of this RTO as to develop the basic market structures and transmission tariffs as proposed in this filing.

The reason for this is that market structure, market power monitoring, and market power mitigation should be integrally related to each other, and without a careful prescription for market monitoring *and mitigation* (which is completely ignored in the WestConnect filing), the underlying market structures can not be agreed to. Some market structures will be more compatible with certain market power monitoring and mitigation processes and procedures than others. Thus, a complete plan for these critical aspects of the RTO must be presented *as a whole*. The market power monitoring and mitigation assessment standard needs to be based on the total rates of return on equity earned by sellers in the markets achieved by summing all the revenues that they receive from all markets together - energy, capacity, and ancillary services. This is the only reasonable basis for "just and reasonable" wholesale rates. Thus, contrary to many FERC orders on this subject, market power monitoring can not be done by looking at the prices in a single market, such as the energy market, *in isolation from the other markets.*

In addition, the WestConnect RTO does not even mention an intention to monitor for market power in the *bilateral contract* markets for generation and transmission services, in addition to its approach to monitoring the spot markets that it plans to establish. Yet, this function also needs to be performed by the RTO. The need for monitoring bilateral contract power markets is also a function of RTOs that FERC has systematically ignored. Not including such a function in the WestConnect filing is another fatal flaw.

3. Transmission congestion should not be managed by developing deregulated and unbundled transmission services, in particular by establishing deregulated congestion charges based on Congestion Redispatch bids, and deregulated secondary markets in firm transmission rights ("FTRs") and related services. These market-based approaches, which are intrinsic to many other RTO proposals in other parts of the US, will likely lead to *decreased* levels of economic efficiency, implying higher transmission and generation prices for customers in the long run. This is particularly likely to be true in the Southwest where load centers are spaced far apart with relatively few transmission lines interconnecting large loads, thus creating many large load pockets. Generation and transmission systems must be dispatched and operated using variable direct *costs*, not unregulated bids, as the key guideline. Mathematically, there is only one way to maximize economic efficiency when operating an existing electric system, and that is to dispatch the generating units subject to transmission constraints and losses based strictly on minimizing the variable costs of operating the generating units. In spite of FERC Order No. 2000, all market-based mechanisms for managing transmission congestion should be rejected for the WestConnect RTO, at least in the near term. Until it can be proven that market-based congestion management mechanisms can potentially lead to lower cost solutions for all customers, and not just big customers, congestion management mechanisms should be limited to

cost-based redispatch mechanisms and equitable cost allocation methodologies for use of the transmission grid. For now, market mechanisms for transmission rights and usage have no place for regulated monopoly service in the WestConnect region.

4. WestConnect is proposing to rely on the wrong "planning objectives" for transmission system planning. Section P.3 of Appendix P states that WestConnect shall develop Regional Transmission Expansion Plans that "are critically needed to support competition," "incorporate planned Generating Unit additions," and which "reduce congestion and potential Generator market power." These are the wrong criteria for good transmission system planning. The only valid criterion for transmission planning is to do transmission system planning on a *least cost* basis by taking into account both potential demand-side investments as well as new generation plants sited in an environmentally sound manner. Good transmission planning is really just least cost electric system planning. Thus, the transmission system should not be planned without performing a complete least cost *resource* plan for a region. Doing least cost system planning will maximize economic efficiency, by definition, and will minimize the cost of electric services to all customers in the long run.

This implies that transmission lines should certainly not be constructed simply to reduce congestion, if doing so is not part of a long-term least cost plan. Some residual amount of congestion is inevitable in an electric utility system. Furthermore, transmission lines should certainly not be built simply to mitigate market power, which should generally be mitigated by other, less costly means, such as by the effective administration of market power monitoring and mitigation methodologies. Similarly, new transmission lines should not be built simply to "support competition" if to do so is not part of a least cost system plan, since the goal of competition should be to achieve the lowest possible prices for electric power to customers.

Finally, new generating units should be planned for sites which minimize total system costs, and not which are only desired by a single market investor. Thus, the transmission expansion plan should not incorporate any new planned generating units that some entity desires to construct, unless they have been sited as part of a least cost electric system planning process.

In addition, the proposed WestConnect Transmission Planning Working Group must include representatives from all relevant state agencies such as state public utility commissions, departments of environmental protection, attorneys general/consumer advocates, energy offices, etc. Thus, WestConnect must broaden participation in all these important activities if it is to have responsibility for transmission planning at all. However, even FERC noted in its November 7, 2001 Order in Docket No. RM01-12-000 that the newly formed Western Electric Coordinating Council ("WECC") handles transmission planning, so WestConnect should probably just coordinate with, but defer to, the WECC when it comes to transmission planning, because the WECC is a broader and more representative regional stakeholder body.

5. Transmission system pricing at the *retail* level should always remain under the jurisdiction of the relevant state public utilities commission, and not FERC. This should be true for both small and large retail customers, whether or not the state commits to retail competition. At the wholesale level, the pricing of transmission services in each state should continue to be strictly based on the revenue requirements of the transmission investments made by the transmission-owning utilities in that state, and not on market-based mechanisms. This approach will provide an incentive for each state to require least cost transmission planning, and FERC should do likewise before any new transmission investments are deemed prudent and, therefore, eligible to be added to any utility's wholesale (FERC jurisdictional) transmission rate base.

The rate design for transmission services at the wholesale level should also be done in a equitable manner so as not to discriminate against low load factor customers. Transmission investments are typically "baseload" investments, intended to bring power into a region at high load factors from distant baseload power plants. It is usually least cost on a system-wide basis to serve local peaking load from local generation and not to rely on imports over the transmission system, since the incremental construction of new transmission lines to serve the peaking load of load pockets can not usually be justified from a least cost perspective, since the new lines would only be used at low load factors. Thus, most transmission investments should effectively be charged to users on a basis that is primarily proportional to energy use, and these charges should not be primarily proportional to peak demand through the use of high demand charges. A 12-month coincident peak demand methodology, as traditionally used by FERC, may be a reasonable compromise approach, but this cost allocation methodology needs to be reviewed with input from the state utility regulatory commissions and consumer advocates in the region.

In light of these extremely serious inadequacies in the October 15, 2001 WestConnect filing, many significant changes need to be made before the Attorney General could approve the concept of transmission-owning utilities within New Mexico joining WestConnect. As highlighted above, and as explained in more detail below, some of the problems with the filing derive from the purposeful lack of detail contained in the WestConnect filing. Other problems with the filing derive from WestConnect's way of interpreting FERC's RTO requirements as set forth in Order No. 2000. However, an additional set of problems derive from FERC's own recommendations and requirements as described in Order No. 2000. Many of FERC's policy conclusions in that order would likely lead all electric utilities to join RTOs that would result in a

significantly less economically efficient electric system in the U.S., thus wasting valuable social resources.

These policy conclusions need to be revisited in light of our experiences with RTOs and Independent System Operators ("ISOs") to date, as FERC attempts to make RTOs into the socially useful institution that electric consumers deserve. Fortunately, FERC has recently opened up many of the market power related issues for comment in Docket No. EL01-118-000, and the filings in that docket should be considered along with filings in the various RTO dockets in an integrated fashion. In fact, the Attorney General will file more detailed comments on market power monitoring and mitigation in Docket No. EL01-118-000, so its filing there must be read in conjunction with its filing here.

The one thing that is clear thus far from both experience in electric power markets in both the West and in the East over the last two years, is that market mechanisms for both generation-related and transmission-related services can readily lead to market power abuses, huge price volatility, and higher electric rates. Clearly, the risks in establishing market mechanisms for electric power are significant, as the likely bankruptcy of Enron so graphically illustrates. This is true for both spot and bilateral contract markets. Thus, more careful thought and guidance than FERC has provided thus far in Order No. 2000 and much more consultation with state authorities is necessary in order to avoid the over-charges for electric services in the form of unjust and unreasonable wholesale rates that customers throughout many regions of the U.S. have had to pay over these past two years.

The Attorney General is also particularly concerned that WestConnect's discussion of market power monitoring and mitigation does not show any evidence at all of having been influenced by the extensive filings and comments on these issues in many dockets at FERC

within the last two years, since Order No. 2000 was issued, relevant to the California and Northeastern markets that FERC approved as part of establishing ISOs in those regions. WestConnect needs to learn what can be learned from the past litigation of these issues, especially from FERC's major June 19, 2001 order on market mitigation in the California and Western markets. WestConnect needs to do its homework, and must prepare a much more detailed and evenhanded RTO proposal, before the New Mexico Attorney General can agree to its approval by FERC.

C. The Market Structure Proposed by West Connect Will Make It Impossible to Monitor and Mitigate Market Power

WestConnect proposes to establish an energy balancing spot market and various ancillary services, but it does not propose to establish an installed capacity market. Yet, in the case of at least the New England ISO, the New York ISO, and the PJM ISO, FERC has recognized the importance of establishing an installed capacity market to balance and complement the energy and ancillary spot markets. Thus, even if it were just for the sake of consistency, all RTOs should have installed capacity markets, if any market mechanisms for generation are established. However, there are many other good reasons for an installed capacity balancing market to be required in all RTO proposals. What FERC has not yet clearly acknowledged is that a primary purpose of having an installed capacity market is so that market prices in the energy spot market during periods of peak demand do not need to be higher than the variable costs of operating peaking units in order to allow generation owners to cover the *fixed* costs of these peaking units. An important secondary purpose for requiring an installed capacity market by each RTO is so that a required reserve margin can be set in a self-consistent manner throughout the RTO region.

Many commentators in many FERC filings over the last two years have argued that FERC needs to allow for bidders into the energy spot markets to recover high bid prices during times of peak demand in order to amortize their fixed costs over these energy sales, in addition to recovering their operating costs. Sometimes the difference between these high bid prices and the cost of providing the power is called a "scarcity rent." It would be necessary for owners of peaking plants that might operate only a few hours per year to collect very high dollar per MWH bid prices during peak period hours if there were no other way in which they could recover their annualized fixed investment costs. If there were no installed capacity market, then, there would be no effective and fair way of monitoring and mitigating high energy market prices during peak

periods (or any period), because there would be no standard as to when an energy-only price bid would be too high. What, for example, would a proper rate of amortizing annual fixed investment costs be for any given hour in the energy market, if one does not know for how many hours such a unit would be dispatched? This is an unanswerable question, and FERC has floundered over the last two years in several orders, including the June 19, 2001 order on price caps in the Western markets, in trying to answer this question both directly in its discussions of market power monitoring, and, indirectly, when addressing the price cap issue.

However, if an installed capacity market also existed along with an energy balancing market in the WestConnect RTO, or elsewhere, presumably this market would clear at approximately the annualized carrying cost of a new peaker (when the balance between supply and demand is fairly tight), and the energy market would clear during peak periods at the operating cost level of similar new peakers. Thus, the total price of power during peak periods based on such a market structure, namely the sum of the energy and capacity market prices, would be just and reasonable, because FERC could readily observe whether or not the implicit return on equity ("ROE") on the peaker investment in the installed capacity market was within a "range of reasonableness" on an annual basis (once a reasonable depreciation rate was assumed). If the total market price of peak period power was lower than this price, obviously that would also be "just and reasonable." A similar analysis would apply during off-peak periods once the infra-marginal revenues for dispatched units were also taken into account when computing the total revenues for each generating unit.

But the main goal of the market power monitoring and mitigation mechanisms established by FERC would be to keep the overall ROE based on the generation sellers' overall investments in new (marginal) generation within a reasonable range. As far as we know this is

the only internally self-consistent approach to making spot market prices "just and reasonable" under the Federal Power Act. Market power monitoring and mitigation in the bilateral contract market would be accomplished in a similar fashion. Longer-term market prices, including bilateral market prices, would be just and reasonable to the extent that they reflected the underlying (traditional) annual costs of the relevant generation units, and a reasonable rate of return. If FERC does not require all RTOs, including WestConnect, to monitor and mitigate for market power in this, or a similar fashion, then market-based generation structures will probably have to be abandoned as not being consistent with the need to produce rates considered "just and reasonable" under the Federal Power Act. Without a market structure that includes some form of an installed capacity market for fixed cost recovery (at least on the margin for new peakers), and an energy and ancillary service market for variable cost recovery, effective market power monitoring is probably impossible, since there would be no way of determining the appropriate "just and reasonable" market-pricing standard to use as a baseline for measuring the effectiveness of the monitoring and mitigation rules.

D. Relying on Market-Based Price "Signals" for Transmission Services to Manage Congestion and to Dispatch the Generation System Will Lead to Higher Transmission Rates and Economic Efficiency Will Suffer

FERC should not confuse the potential value of relying on price signals in certain markets for incentivizing new investment with the economically efficient way of operating a system of transmission and generation facilities *once they exist.* Thus, the potential usefulness of market-based price signals for transmission services for *planning* the transmission system versus *operating* the transmission system must be clearly distinguished. However, these two possible uses of price "signals" are often confused. The goal of providing the lowest reasonably priced electric service to customers, which is FERC's goal, can only be accomplished if two sub-goals are achieved. First, the transmission/generation system must be planned in a least cost manner, according to traditional least cost planning principles, with environmental impacts directly taken into account. Second, at any point in time, the existing transmission and generation system must be operated in the least cost manner. Unfortunately, it is very unlikely that the use of the mechanisms proposed by WestConnect for both transmission system congestion management (system operations), and for transmission system planning, will lead to either of these two sub-goals.

The issue of least cost system operations is the easier issue to address. As WestConnect points out on page 27 of their filing, FERC has emphasized in Order No. 2000 that it wants congestion pricing proposals to achieve two goals: (1) ensuring that "the generators that are dispatched in the presence of transmission constraints are those that can serve load at *least-cost*" (emphasis added), and (2) ensuring that "limited transmission capacity is used by Market Participants that value that use most highly." Unfortunately, FERC does not seem to have realized over the past two years since Order No. 2000 was released that these two goals are

logically and mathematically *contradictory*. There is only one way to dispatch an existing transmission/generation system at least cost. Having market mechanisms like auctions for FTRs, which WestConnect proposes, is, therefore, bound to lead to higher *cost* solutions, even if the FTRs are purchased by those who value the use of the transmission routes the most highly. This point should not be controversial, but it implies that FERC must revise its goals regarding congestion management as enumerated in Order No. 2000.

The one thing we definitely know about electric systems is that the least cost way to operate them, once they are built, is to dispatch all the generating units subject to transmission and engineering constraints based strictly on the variable costs of operation. This is a truism mathematically. Any deviation from this approach leads to higher system costs, and higher costs to ratepayers, which is why this is how all tight power pools were operated until restructuring was implemented in the 1990s. Thus, "congestion management" is basically an issue in that it is *automatically* addressed by the system operator of a tight power pool on a least cost basis. When congestion occurs, some power plants are "redispatched" based on their relative variable operating costs. No market mechanism is needed to *deal with transmission congestion.* In addition, if a market-based mechanism is proposed to deal with this issue, as WestConnect has proposed, the proponent has a legal obligation to show that this mechanism will not lead to higher costs to ratepayers as a whole. Yet, we know mathematically, that if the redispatch of generating units is done based on any bid prices which are not just equal to the marginal operating costs of each generating unit at that time, the redispatch will not be economically efficient. It will not be least cost. Thus, how can the WestConnect proposal for congestion management lead to "just and reasonable" transmission costs to all customers? It, most likely, can not. Of course, since FERC was the author of the concept that congestion management

could be handled through the use of market-based mechanisms as discussed in Order No. 2000, it is FERC that must go back to the drawing board regarding how congestion management should be handled for all RTOs proposed in the U.S.

The issue of economically efficient or least cost transmission system *planning*, as opposed to system operation, is somewhat more complex. Here one could imagine that at least in principle, market-based transmission service prices could give potential investors in new transmission or generation the proper price "signals" that would induce them to invest in the right new transmission and generation facilities in just the right locations, at just the right times, in order to lead to a least cost joint transmission/generation system over the long run. The problem is, in the case of transmission, that while this could conceivably happen in principle, it is very unlikely to happen in practice. This is especially true when one includes the necessary and complex siting considerations that need to be taken into account when building both new transmission lines, as well as new generating units. In addition, to do economically efficient or least cost system planning, demand-side management ("DSM") options must also be considered. One practical aspect of the problem of attempting to get transmission prices for FTRs, or congestion prices, to properly signal the need for specific new transmission lines is that those price signals necessarily will vary significantly for any location in the transmission grid from hour to hour, from week to week, and from year to year. In addition, because of this tremendous volatility that will be inherent in market-based price signals for transmission services and for congestion, it will be almost impossible to determine how such market-based price signals might change over the entire period of the expected lifetime of a new transmission line being considered. Yet, least cost planning must be performed over a long time horizon, especially for long-lived and capital intensive investments like transmission line investments. Long-term

electric system planning must be reviewed by state and regional regulators; it can not be left to very unclear and volatile market pricing "signals" to accomplish the right social goals. It is almost impossible that this could work in a way that would satisfy the residents and electric consumers of any state, especially since it is extremely unlikely that such a process would even come close to least cost transmission/generation/DSM system planning.

Again, a potential investor in such a new transmission line would need to have the complex information available as to hourly FTR and congestion prices for the next 20 years, or more, before deciding if constructing such a line would be profitable in light of the market structure established for the purpose of sending those very price signals. In contrast, even though a least cost planning process would still require various forecasts to be made, such as load forecasts, fuel price forecasts, etc., it would be much simpler and less uncertain to make these types of long term forecasts on an average basis, than to forecast the even more volatile market-based prices for firm transmission rights, recallable transmission rights, etc., which themselves depend on such forecasts. When dealing with monopoly services like transmission, creating market mechanisms for pricing (even if based on a total revenue requirement as a control total) will also usually lead to much more volatile prices for certain portions of the transmission system, which could lead to discriminatory pricing for many customers.

Secondly, least cost planning for new transmission and generation investments will not necessarily serve the purpose of enhancing competition in the wholesale generation markets. Strictly speaking, to do so would be another logical contradiction, for then the system would most likely not be a *least cost* system. First, one needs to do least cost system planning (and subsequent least cost construction of new facilities). Then, one needs to determine if, given the transmission constraints and the location of the generating units, workably competitive

generation markets can exist. Of course, often the answer will be "no," especially once the pattern of ownership of the generating units is taken into account. But if market power might or will likely exist given the *physical* structure of the transmission/generation system, then it must be eliminated by *other means*, and not by *overbuilding* the transmission grid. While overbuilding the transmission grid could reduce the potential exercise of market power, it would also just add costs that all customers would have to pay. Thus, there would be no point in establishing competitive (deregulated) wholesale generation markets which would aim to reduce the cost of generation to ratepayers below traditional cost-based rates, if the cost of doing so was to so significantly add to transmission system costs, that net costs would be higher. To do so would only lead to a situation where the sum of the transmission and generation rates would be higher than under traditional rate regulation, and higher than would occur if market power were eliminated by effective monitoring and mitigation rules, if possible.

E. Jurisdiction for Setting the Retail Rates for Transmission Services Must Always Remain with the State Public Utilities Commissions

The Attorney General can not agree to allow the transmission owning electric utilities within the state of New Mexico to join WestConnect if FERC does not agree that the New Mexico Public Regulation Commission ("NMPRC") will retain the right to set *retail* transmission rates for all customers. Furthermore, at the wholesale level, the total revenue requirement for transmission services should be no higher than the level that would be established based on prudent least cost transmission system planning, and from traditional cost-based rate regulation. For example, FERC should not allow any financial incentives for transmission investments in WestConnect over and above the traditional regulated return on equity to be paid to any owner of old or new transmission investments within WestConnect. If the WestConnect applicants want to propose a for-profit transmission company, then their return

on equity must be limited to the normal regulated level. Of course, if this is done, it is not clear to the Attorney General why the applicants desire to be a for-profit RTO. Similarly, FERC should not approve any form of accelerated depreciation for either old or new transmission system investments, which might provide a further financial incentive for the applicants to propose a for-profit transmission company. Finally, market-based mechanisms for the purpose of allocating transmission costs should only be allowed by FERC if the Applicants demonstrate that they are consistent with both least cost system operations, and least cost system planning, as FERC itself claims to desire. However, thus far, the Applicants have not made such a showing, and, therefore, all the WestConnect market-based proposals for congestion management and for transmission system pricing should be rejected.

F. Establishing a Tight Power Pool Instead of the Proposed WestConnect RTO Might Be a Better Means to Reducing Ratepayer Costs in the Desert Southwest

FERC should consider modifying and broadening its conception of RTOs from the narrow conception presented in Order No. 2000 as the only acceptable way to attempt to both reduce wholesale electric rates and to allow open access to the transmission grid. FERC committed to do so on page 3 of its November 7, 2001 order in Docket No. RM01-12-000. FERC should reconsider the many benefits of the tight power pools that existed in the U.S. prior to 1995, such as PJM, Nepool, and the New York Power Pool. (Note that utilities owned by the same holding company like the Southern Company subsidiaries are still operated like a tight power pool, because this is the lowest cost way to operate a transmission/generation system. There are good reasons why the Southern Company, for example, does not set up internal market mechanisms for the purpose of having its subsidiaries compete against each other for transmission services and for the right for its generating units to be dispatched.) If cost

reductions for consumers can be obtained by more efficient, or more highly coordinated, transmission/generation system operations in the desert Southwest, or through more efficient system planning, then establishing a traditional tight power pool with variable cost dispatch might be the best option facing the Southwest. This may particularly be true in this region of the country due to the numerous urban load pockets and long and sparse transmission interties between these load pockets.

There are several reasons why establishing a tight power pool in the desert Southwest might be preferable for that region, in particular, when compared with FERC's current conception of an RTO. This is especially true if such a power pool were run by an independent governance body like an RTO, contrary to the governance approach taken in the older power pools. First, a tight power pool ensures non-discriminatory and open access to all internal transmission lines because the use of those lines would be made strictly on a least operating cost basis. This is automatically true for generating units located internally to the power pool, and could be easily applied to the dispatch priority of generating units and purchased power contracts from outside the power pool. As noted above, this would eliminate the need for any congestion management scheme the purpose of which would be to decide who should pay for congestion. It is very important to note that another problem with establishing market-based mechanisms for the purpose deciding who will pay for congestion not mentioned above, is that market-based mechanisms are likely to result in an unfair allocation of cost responsibility. Congestion is inherently a systemic issue, and is caused to some extent by all the flows on a transmission system at any given time. One can not legitimately say that utilizing the last contract path to meet the last increment of load is more responsible for any resulting congestion somewhere in the grid than utilizing the first set of contract paths needed to meet the initial baseload portion of

the load. Attempting to assign responsibility for congestion to specific loads is a completely arbitrary activity once a system is being dispatched on a least cost basis. Thus, the assignment of congestion costs to particular customers becomes completely arbitrary. (This is a typical situation of trying to allocate "joint and common" costs.) Since there is no "right" answer for which load causes congestion, there is no simple way to determine who, if anyone, should pay for congestion. If all loads need to be met in a given hour, then there is only one least cost dispatch manner of meeting those total loads. FERC's traditional network service tariff for transmission based on a 12 coincident peak methodology for allocating the costs of using the transmission system was, actually, a reasonably fair methodology for allocating all the costs of using the transmission system including congestion costs, though transmission costs should ideally be allocated on a more energy-weighted basis. In addition, some sort of a simple "split savings" approach to allocating variable generating unit operating costs among generation owners is also a fair way to share the savings implied by a least cost dispatch relative to the costs that each load serving entity would have had to incur to meet its load relying solely on its own resources. Thus, a split-savings mechanism can be used to fairly allocate both congestion and redispatch costs.

Secondly, solving the "seams" issues with respect to interfacing with neighboring power pools or RTOs would probably be no more difficult for a tight power pool to do than for an RTO, and probably less difficult since most operating activities would be based directly on costs, and not market-based bids.

Thirdly, transmission planning could proceed in the same manner within a tight power pool as within an RTO. The same least cost planning principles need to be applied in both cases. In fact, the cost-based split savings approach for sharing the operating costs of the generating

units within a tight power pool is likely to provide a stronger collective incentive for least cost system planning, since all load serving entities and generation owners would benefit to some extent. This incentive would also be strengthened through a return to FERC's traditional network service tariffs, so that each load serving entity would be billed for transmission service based on a pro-rata share of their use of a least cost system, implying that the overall transmission revenue requirement would be as low as reasonably possible.

Thus, the "bottom-line" is that FERC has been quite rigid in attempting to mandate that all transmission-owning utilities in the U.S. join an RTO of the type spelled out in Order No. 2000. There are other alternatives to that type of an RTO that may make more sense in a region with the characteristics of the desert Southwest, like a tight power pool, especially if independent governance is established for such entities. It would also be important that state public utilities commissions could retain some of their traditional rate-making and planning authority even if such an alternative, independent entity for operating the transmission grid were established. Joint planning boards are needed to oversee the split between federal and state jurisdictional issues. Certainly, one advantage of first moving to an alternative entity like a tight power pool in the Southwest, in contrast to allowing the WestConnect proposal to move forward, would be to first determine to what extent system operating costs can be reduced by such a entity, and to allow for greater rate stability than market mechanisms typically imply. Putting a tight power pool in place would also push the all too real specter of rampant market power off into the future, perhaps permanently. If an independently governed power pool in the Southwest were to be successful, then an appropriate cost/benefit analysis might show that implementing FERC's current (or by then, improved) conception of an RTO may not be cost effective when measured from the correct cost baseline, namely from a baseline whereby a tight power pool has already

been given the opportunity to reduce system costs to the maximum extent that it can. The New Mexico Attorney General urges FERC to reconsider its overly hurried attempt to rush through the current RTO process, and urges FERC to judiciously consider a full range of potentially more desirable options to the WestConnect proposal.

To repeat, whether or not FERC takes our advice to consider a broader range of approaches to restructuring which takes into account the fact that New Mexico and other states in the Southwest have not yet established retail competition, and may never do so, FERC should completely reject the current WestConnect filing as requiring substantial modification and improvement, particularly with regard to a wide-range of issues related to market power monitoring and mitigation. FERC should not accept any RTO proposal if specific and detailed proposals for these vital services necessary to protect all customers are lacking.

G. Concerns Over Potential Shifting of Costs and Jurisdiction

Currently, the NMPRC has jurisdiction over the allowed revenue requirement, class cost-allocation and rate-design for retail bundled-service customers. This jurisdiction covers all functional components of the bundled service – including transmission and ancillary services. Moreover, the rates approved by the NMPRC are justified by the utility's actual cost-of-service including a fair return to utility assets used to serve these for retail bundled-service customers. Retail rates in New Mexico, as is the case currently in most states, are not based on what the utility's assets could earn in a market.

In the end, electric industry policy must admit to a choice between two imperfect worlds. The first is a market-based world where firms have incentives to minimize cost but where market power may significantly raise price above cost. The second is a regulated world where price

reflects cost but firms may not have an incentive to operate in a least-cost fashion. Neither perfect regulation nor perfect markets are obtainable.

Deregulation does not guarantee competitive outcomes – it just guarantees that rates will be market-based. If suppliers possess market power, then they will be able to raise market prices above competitive benchmark levels. Potential market power – both vertical and horizontal – in electricity markets should be a concern to individuals crafting public policy regarding restructuring.

Currently – and into the foreseeable future – we do not see western energy markets as being workably competitive. This is especially true in New Mexico where the ownership of generation, wires and ancillary services assets are dominated by a few firms. Moreover, limited transfer capability into New Mexico limits access by wholesale generation markets external to the state. We believe that the interests of residential and small commercial customers of New Mexico are best served by preserving the current process of state-determined cost-based rates.

Unlike Arizona, New Mexico is not currently a direct-access state – all retail customers receive bundled service. Therefore, in this pleading the Attorney General has primarily evaluated the WestConnect filing with a view towards how the petitioners' RTO plan might affect small New Mexico retail customers absent direct access. The Attorney General's concerns outlined in this filing, however, do transfer to a situation wherein New Mexico becomes a direct-access state. The Attorney General believes that the benefits of competitive opportunities that may exist will most likely accrue to large customers and that the vast majority of residential and small commercial customers will most likely opt for continued bundled service under a "standard-offer contract" with their local utility.

It is clear from Orders 888 and 2000 that the FERC expects the RTO to set both wholesale and unbundled retail transmission rates (that is, true unbundled retail transmission rates in a situation where retail customers are allowed – and choose – an alternative supplier). State commissions currently have the authority to set bundled transmission rates. The NMPRC must maintain its current jurisdiction over bundled rates. Yet, it appears that the FERC may be setting requirements for both bundled and unbundled tariffs to be non-discriminatory. This raises the specter of federal preemption – a possibility that the New Mexico Attorney General protests. Why should bundled and unbundled tariffs be non-discriminatory given that the benefits from deregulation are, arguably, discriminatory?

Simply put, we are against any change to the current state-determined process that might lead to an increase in prices paid by New Mexico retail customers for bundled electric service. We applaud the petitioners' efforts in developing a plan that mitigates cost shifting. For example, by basing the Access Area Rates on a "license-plate" approach rather than a "postage-stamp" approach, a (potentially large) redistribution of transmission costs is thwarted. However, unless the NMPRC maintains its full jurisdiction over all the components of bundled-service retail rates, we still have concerns over the possibility of cost shifting.

Both Public Service Company of New Mexico ("PNM") and El Paso Electric Company ("EPE") are Participating Transmission Owners ("PTOs") in WestConnect. They are also the utilities that currently provide bundled service to approximately 55% of the New Mexico retail load located in the WSCC.[1] Under the WestConnect plan, these utilities would become Eligible

[1] By comparison, Arizona Public Service Company ("APS") and Tucson Electric Company ("TEP") – the two other Participating Transmission Owners in WestConnect – provide bundled service to approximately 50% of the Arizona retail load. Salt River Project ("SRP") is considering joining WestConnect as a Participating Transmission Owner. APS, TEP and SRP combined provide bundled service to approximately 85% of the Arizona retail load. According to petitioners, they have also initiated talks with members of the TransConnect faction of RTOWest, for example, Nevada Power Company. Should Nevada Power Company and Salt River Project join WestConnect, the Participating Transmission Owners would represent entities that provide bundled service to approximately 83% of the retail load in the Arizona/New Mexico/Southern Nevada Subregion of the WSCC.

Customers of WestConnect and would procure – from WestConnect – transmission and ancillary services on behalf of their retail load. A utility would be billed by WestConnect for services rendered based on a host of WestConnect fees. A large portion of this revenue would be distributed back to the utility because it is still an owner of transmission assets. In a sense, the utility "pays itself" for transmission services along the assets it owns but WestConnect manages. Moreover, a large portion of the revenue generated from

WestConnect's ancillary services markets would flow to the utilities/PTOs because they would be the dominant suppliers of ancillary services. Additionally, the utilities/PTOs would receive and pay wheeling fees from/to WestConnect just as they do now for their wholesale transactions outside the WestConnect area.

Currently, in order to determine the transmission component of the bundled-service retail rate, a state commission basically determines a utility's *total* transmission revenue requirement, subtracts the net of wholesale wheeling fees received/paid (fees that are determined by the FERC), allocates this *net* transmission revenue requirement (i.e., net of wholesale revenues received less paid) to retail customer classes, and then divides by the jurisdictional retail load of each class. There is no reason why this process should be fundamentally different should WestConnect manage the utilities' transmission assets. It is noted that the utility's state-determined *total* transmission revenue requirement could be different from the annual transmission revenue requirement ("ATRR") assessed by WestConnect and found on Schedule A in Appendix O of the WestConnect Filing. This is the case today: the state determined total transmission revenue requirement can be different from that determined by the FERC in FERC's determination of wholesale wheeling fees.

New Mexico retail customers are already paying for bundled service. The current rates they pay already include all of the services that WestConnect would provide the utilities/PTOs. The NMPRC needs to maintain its jurisdiction over these bundled service rates so that they remain cost-based and so that New Mexico customers do not end up paying more for exactly the same service they currently receive. Specifically, the Attorney General has the following concerns that should be resolved under the jurisdiction of the NMPRC:

- The NMPRC should continue to have jurisdiction over determining the utilities total and net transmission requirement so that any additional revenue the utility receives through its transactions with WestConnect is accounted for.

- The fees the utility would pay WestConnect should not automatically become a pass-though in determining the net transmission revenue requirement used for retail bundled-service customers. The NMPRC should cap such fees at their current levels. For example, if the Grid Management Charge (for WestConnect's scheduling, billing and dispatching services) is greater than what retail customers currently pay for those services being provided by the utility, the difference should not be recoverable from retail bundled-service customers.

- The revenues paid by retail bundled-service customers for ancillary services should be capped at their cost-based levels. To the extent that WestConnect's markets for ancillary services are not fully competitive, prices for these services would be above their cost-based levels. New Mexico retail bundled-service customers currently receive all required ancillary services and pay cost-based rates for such services. The NMPRC should retain jurisdiction over these revenue and rate determinations.

- The NMPRC should determine if The Transmission Adjustment Charge should be recoverable from its retail customers. The salient issue surrounding this determination is whether or not New Mexico retail customers of bundled service receive any real benefits (*over and above* those that they are currently receiving and paying for) from non-jurisdictional transmission owners like WAPA participating in WestConnect.

H. Concerns Over the Collaborative Process

A collaborative process – that included all stakeholders – had been established for several years. The objective of this process was to develop a not-for-profit RTO called Desert Star. Some of the appendices found in the current WestConnect filing contain the results of this collaborative process. Additionally, a Desert Star board of directors was chosen with the approval of the stakeholders.

Approximately one month prior to when the Desert Star RTO proposal was to be filed at the FERC, the Petitioners in the WestConnect RTO filing unilaterally abandoned the Desert Star process as well as the stakeholder-approved board of directors and announced that they were

filing a for-profit Transco RTO. The stakeholders from the Desert Star process were not consulted in the development of the WestConnect RTO filing.

At best, the decision to develop the WestConnect RTO filing in the absence of stakeholder input violates the spirit of FERC order 2000. At worst, it casts grave suspicion on whether the Participating Transmission Owners (who are themselves market participants) are truly independent of the WestConnect RTO itself.

I. Independence and Market Monitoring

The Market Monitor should be independent of the "for profit" WestConnect RTO with a separate budget funded by a transmission tariff added on the West Connect tariff.

One of the major faults of the WestConnect filing is the lack of independence of the market monitoring function from the "for profit" RTO and its relationship to transmission owners. Of all the necessary independent characteristics of a RTO, a completely neutral market monitoring function is one of most essential. The desert Southwest region is a small region dominating by a few incumbent utilities. There are significant constrained transmission paths into major urban areas. Thus there is significant potential for the exercise of market power. A "for profit" RTO is a market competitor with other participants; certainly the provision of transmission is a competitive substitute for local generation. WestConnect will seek to maximize its return on investment. Over time, WestConnect will acquire transmission and possibly ancillary services assets. Given that WestConnect revenues will be constrained by regulated tariffs, growth in profits can best be achieved by more volume (i.e. more transmission service) and the profitable provision of ancillary services. In FERC Order No. 2000 at pp. 441-442, the following is stated:

> Most commenters raise concerns about and generally oppose a for-profit RTO monitoring markets. The commenters generally argue that, due to its economic

> and business interests, a for-profit RTO cannot objectively monitor itself. CP&L submits that a for-profit RTO may be a competitor of other market participants in the provision of congestion relief and ancillary services, which would make unbiased monitoring of those markets difficult. TDU Systems would limit a for-profit RTO's role to data collection. Other commenters recommend that for-profit RTOs employ a fully independent organization to monitor market conditions. A few commenters, however, support for-profit RTOs serving as market monitors. Entergy claims that market monitoring conducted by a transco could be as effective as for any other type of RTO as long as procedures are in place that ensure its independence. (Emphasis added.)

We focus on the last statement because particularly troublesome is the lack of specific market monitoring assessment standards (H.4) in Appendix H (Market Monitoring) of the West Connect filing. WestConnect promises to develop these standards at a later date, but after the WestConnect filling is approved. Why were the standards not developed by the time of filing? One could suspect that market monitoring is of secondary interest to WestConnect - all the more reason that WestConnect should have proposed a completely independent market monitoring function from its own organization.

Many of protestants in response to WestConnect RTO filing have noted the lack of independence of WestConnect Board selection and financing from its financial contributors, the participating transmission owners (see Motion to Intervene and Protest of Enron Power Marketing Inc; Motion to Intervene and Protest of Duke Energy North America, LLC and Teco Power Services Corporation; Motion to Intervene and Protest of Western Power Trading Forum and others). We will not reargue these points here except to note that the proposed Market Monitoring and Tariff Compliance Group outlined in Appendix H is functionally subordinate to the Chief Executive Officer (H.7.b), the salary of Head of MMTCG will be determined by WestConnect Board of Directors along with the market monitoring budget. If WestConnect is not independent, quite simply, neither will its market monitoring be unbiased.

II. CONCLUSION

The New Mexico Attorney General believes that the Commission should reject the WestConnect filing and restructure its RTO process in conformance with these comments.

Respectfully submitted,

PATRICIA A. MADRID
Attorney General

/s/

Jeff Taylor
Assistant Attorney General
P. O. Drawer 1508
Santa Fe, NM 87504
(505) 827-7484

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Arizona Public Service Company El Paso Electric Company Public Service Company of New Mexico Tucson Electric Power Company	Docket No. EL02-9-000
WestConnect RTO, LLC	Docket No. RT02-1-000
Electricity Market Design and Structure	Docket No. RM 01-12-000

REQUEST FOR ADDITION TO SERVICE LIST

The Office of the New Mexico Attorney General requests that the following individual be added to the service list in the above-captioned proceeding.

Richard A. Rosen
Tellus Institute
11 Arlington Street
Boston, MA 02116-3411

Respectfully submitted,

PATRICIA A. MADRID
Attorney General

/s/

Jeff Taylor
Assistant Attorney General
P. O. Drawer 1508
Santa Fe, NM 87504
(505) 827-7484

CERTIFICATE OF SERVICE

I hereby certify that I have this day filed the foregoing documents at the Federal Energy Regulatory Commission by electronic filing and served a copy upon each person designated on the official service list compiled by the Secretary in this proceeding.

I further certify that the paper copies mailed to the parties on the official service list contain the same information as contained in the electronic media filing, that I know the contents of the electronic media and the paper copies and that the contents as stated in the copies and on the electronic media are true to the best of my knowledge and belief.

Dated at Santa Fe, New Mexico, this 30th day of November, 2001.

/s/

Jeff Taylor
Assistant Attorney General
P. O. Drawer 1508
Santa Fe, NM 87504
(505) 827-7484